

BEFORE THE
POSTAL REGULATORY COMMISSION

Periodic Reporting
(UPS Proposals One, Two, and Three)

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:
: Docket No. RM2016-2

UNITED PARCEL SERVICE, INC.'S RESPONSE TO
CHAIRMAN'S INFORMATION REQUEST NO. 5

United Parcel Service, Inc. ("UPS") respectfully submits the following response to
Chairman's Information Request No. 5 (Dec. 18, 2015).

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1. **Please refer to the chart entitled “Y/Y Change in Market Share for Priority Mail/Ground Volume” on page 14 of the UPS Response to Chairman’s Information Request (CHIR) No. 1.**

- a. **Please provide the UPS, FedEx, and USPS market shares that were used as inputs to this chart. Please provide market share data for every quarter from 3Q2013 to 4Q2015.**

The information used to create the graph “Y/Y Change in Market Share for Priority Mail/Ground Volume” can be found in the ‘PM_GND Market’ tab of the workbook titled ‘CHIR No. 1 Market Share Analysis,’ which UPS is filing along with this response.

- b. **Please provide the exact data sources and worksheets that UPS used to develop the numbers in the chart.**

The ‘PM_GND Market’ tab also provides links to the source data and calculations used to produce the graph.

- c. **Please confirm that Priority Mail is a product that uses both ground and air transportation, while the UPS Ground and FedEx Ground use ground transportation only. If confirmed, please explain why these products are compared with each other, and discuss whether there are more directly comparable products offered by UPS and FedEx that correspond with Priority Mail. If not confirmed, please describe the modes of transportation used by each of the three aforementioned products.**

Confirmed in part.¹ UPS’s service levels are not mode-specific, and shippers do not generally select products based on the mode of transportation. Rather, shippers generally consider a combination of characteristics, including time in transit, service levels and guarantees, and price. Priority Mail, UPS Ground, and FedEx Ground² have

¹ UPS Ground regularly utilizes air transportation outside the 48 contiguous states. When operational conditions allow or require, UPS also transports Ground volume by air within the 48 contiguous states. Ground transportation, however, is the predominant mode of transport for UPS Ground.

² Some sources compare FedEx Home Delivery to Priority Mail and UPS Ground. FedEx Ground and FedEx Home Delivery are similar services: FedEx Ground is primarily for commercial deliveries and FedEx Home Delivery for residential deliveries. See FedEx, *Service Guide* (last accessed Jan. 8, 2016),

comparable characteristics, and these products are often viewed as comparable by Wall Street analysts,³ business journals,⁴ third party shipping services,⁵ and the Postal Service itself.⁶ UPS is not aware of any its products being considered more directly comparable to Priority Mail.

- d. **Please confirm that the market shares shown in the chart are shares of volume. If not confirmed, please explain how UPS defined the market shares in the presented chart.**

Confirmed.

- e. **Please confirm that the Postal Service's market share of revenue is smaller than its market share of volume. If not confirmed, please explain.**

Confirmed. The Postal Service's market share of revenue is smaller than its market share of volume because the Postal Service earns less average revenue per piece than its private competitors, in part due to the Postal Service's ability to charge prices for its competitive products that do not reflect all of the costs attributable to those products.

<http://www.fedex.com/us/service-guide/choose-service/package-shipments/us-packages.html>. FedEx includes FedEx Home Delivery in FedEx Ground figures in its financial reports.

³ See, e.g., Morgan Stanley Research, *Leveling the Parcel Playing Field* at 2, 4 (May 26, 2015) (comparing Priority Mail to UPS and FedEx Ground in displaying domestic parcel market share and in analyzing the effect of the Postal Service's September 2014 Priority Mail rate cuts); UBS Global Research, *U.S. Small Package* at 40 (Dec. 11, 2014) ("The USPS product most comparable to UPS or FDX Ground service is Priority Mail, which offers delivery in 1, 2, or 3 business days.") Like many analyst reports, these reports are made available only to paying subscribers.

⁴ See, e.g., Laura Stevens, *U.S. Mail Cuts Prices, Chafing UPS and FedEx*, WALL ST. J. (Sep. 4, 2014), <http://www.wsj.com/articles/u-s-mail-cutting-rates-to-win-e-commerce-business-1409850185>.

⁵ See, e.g., Stamps.com, *Study Shows USPS Beats UPS, FedEx on Delivery Times and Cost* (Mar. 19, 2014), <http://blog.stamps.com/2014/03/19/study-shows-usps-beats-ups-fedex-on-delivery-times-and-cost/>.

⁶ U.S. Postal Service, *Don't Get Boxed In* (last accessed Jan. 8, 2016), <https://www.usps.com/dimensionalweight>.

2. **Please confirm that both UPS and FedEx increased their use of dimensional weight pricing on or about the beginning of Calendar Year 2015.**
 - a. **If confirmed:**
 - i. **Please explain in detail the extent to which dimensional weight pricing was expanded.**
 - ii. **Please also indicate the date (or range of dates) when this expansion occurred.**

Confirmed. Prior to late 2014, UPS applied dimensional weight pricing to Ground packages measuring three cubic feet or greater and to packages transported by air. On December 29, 2014, pursuant to an earlier announcement, UPS began applying dimensional weight pricing to Ground products measuring less than three cubic feet.⁷ FedEx began applying dimensional weight pricing to ground products measuring less than three cubic feet at the beginning of 2015.⁸

With an increase in larger but lighter weight e-commerce shipments, cubic volume has become a key cost driver for Ground products as vehicles now typically reach their cubic capacity before reaching their weight capacity.⁹ As a result, UPS's use of dimensional weight pricing better aligns its prices with its products' cost drivers.

⁷ UPS, *UPS Announces Dimensional Weight Changes* (Jun. 17, 2014), <https://www.pressroom.ups.com/pressroom/ContentDetailsViewer.page?ConceptType=PressReleases&id=1426329747295-300> ("UPS has been researching the potential expansion of dimensional-weight pricing for a number of years because it enables us to more appropriately align rates with costs which are influenced by both the size and weight of packages," said Alan Gershenhorn, UPS executive vice president and chief commercial officer."). UPS calculates dimensional weight by dividing the cubic size of a ground package in inches by a divisor of 166. The customer's billable weight is the greater of the actual or the dimensional weight.

⁸ See FedEx, *FedEx Announces Pricing Changes* (May 2, 2014), <http://about.van.fedex.com/newsroom/global-english/fedex-announces-pricing-changes/>.

⁹ An industry analyst called the expansion of dimensional weight pricing "inevitable" because "[i]n every other mode of transportation, pricing is based on the combination of volume and weight. The Carriers typically run out of space in their trucks

- iii. **Please explain the effect of the increase in the use of dimensional weight pricing by UPS and FedEx on their market shares in the Residential Priority Mail/Ground (or separate comparable market identified in response to question 1.c) market and Commercial Priority Mail/Ground market (or separate comparable market identified in response to question 1.c).**

After UPS and FedEx separately announced future changes to dimensional weight pricing in USPS 3Q2014, UPS and FedEx Ground continued to exhibit volume growth in 3Q2014 and 4Q2014, and Priority Mail experienced volume growth declines.¹⁰ After the Postal Service slashed rates for Priority Mail in late 4Q2014 (*before* the expanded dimensional weight pricing was implemented), the opposite occurred: in 1Q2015 UPS and FedEx saw volume growth declines, and Priority Mail saw sharp increases in volume growth. These volume growth declines for UPS and FedEx coincided closely with the Priority Mail rate decreases; they did not coincide with either the announcement or the implementation of expanded dimensional weight pricing.

Starting in 2Q2015 when dimensional weight pricing was implemented, its impact was minimal. An industry analyst observed in a recent article that many customers

and planes long before they exceed weight limits.” Thomas Anderson, *Announcing the Upcoming UPS and FedEx Dimensional Weight Penalty* (Jun. 18, 2014), <http://parcelindustry.com/article-4027-announcing-the-upcoming-ups-and-fedex-dimensional-weight-penalty.html>; see also U.S. Postal Service Office of Inspector General, *Dim Weight, Bright Idea?* (Jun. 9, 2014), <https://www.uspsoig.gov/blog/dim-weight-bright-idea> (“Shipping costs are heavily influenced by how much cubic volume a parcel takes up in the back of a truck or plane. If parcels are roughly uniform in density (weight in relation to size), then charging by weight makes sense. But if parcels are light yet bulky, such as shoes, diapers, and many other goods ordered online, then weight-based pricing doesn’t reflect costs.”).

¹⁰ Consistent with UPS’s Response to CHIR No. 1, and in an effort to ease comparisons for three companies with different fiscal years, UPS presents results for the three companies using the Postal Service’s fiscal year, which begins in October. See Updated UPS Response to CHIR No. 1 at 13, n.24 (Dec. 15, 2015).

received concessions in the form of delayed implementation, waivers, and reduced weight divisors, all of which mitigate the impact of dimensional weight pricing.¹¹

The concessions described by this industry analyst and the timing of the Postal Service's market share gains (*after* it cut Priority Mail rates but *before* the expansion of dimensional weight pricing) support the conclusion that the changes identified by UPS were driven by the Postal Service's dramatic rate cuts and not by the announced dimensional weight pricing changes.

b. **If not confirmed, please explain.**

N/A.

¹¹ Mark P. D'Amico, *Impact of Dimensional Weight Pricing Less Than Expected*, THE JOURNAL OF COMMERCE (Sep. 14, 2015), http://www.joc.com/international-logistics/impact-dimensional-weight-pricing-less-expected_20150914.html.

3. **Please refer to the chart entitled “Commercial (IBI/PI) Priority Mail Volume Growth vs UPS/FedEx Ground (Y/Y)” on page 15 of the UPS Response to CHIR No. 1.**

a. **Please provide the exact data sources and worksheets UPS used to develop the numbers presented in the chart.**

UPS, FedEx, and USPS volume information used to create the graph

“Commercial (IBI/PI) Priority Mail Volume Growth vs UPS/FedEx Ground (Y/Y)” can be found on the ‘Commercial PM_GND Market’ tab of the attached workbook titled ‘CHIR No. 1 Market Share Analysis.’

b. **Does the increase in Commercial (IBI/PI) Priority Mail Volume (shown in the chart) reflect migration from Residential (non-IBI/PI) Priority Mail Volume or any other Postal Service product? If so, please identify and explain the analytical methods that UPS performed to develop the numbers used as inputs to the chart.**

No. If volume migrated from Residential or Retail Priority Mail to Commercial Priority Mail, then the percentage of Residential or Retail Priority Mail volumes would have decreased and Commercial Priority Mail volumes would have increased, but Commercial (IBI/PI) Priority Mail volume has consistently comprised 76-80% of total Priority Mail volume since before the rate cuts were announced.

4. **Please refer to Table 1 on page 22 of the UPS Response to CHIR No. 1. Please explain why Proposal One is estimated to have no effect on the cost of several products. Please provide a separate explanation for each unaffected product.**

Dr. Neels derived the impact calculations presented in Table 6 of his report, and in Table 1 of the UPS response to CHIR No. 1, in two steps. First, he distributed the inframarginal costs within each relevant component to products or services using the Cost and Revenue Analysis (“CRA”) Model Cost Matrix B (“Matrix B”) based upon the proportional distribution of attributable costs within each component. Next, he matched these products or services, when possible, to the Public Cost and Revenue Analysis (“PCRA”), in order to report cost impacts that were consistent with the public reporting conventions of the Postal Service.

There are a handful of products or services (comprising less than 5% of total attributable costs under current costing procedures) for which Table 1 does not report a cost impact from UPS Proposal One. There are two general reasons why this can occur. The first is that, across all of the components containing inframarginal costs, no attributable costs are currently allocated to the product or service in question. This situation implies that the true cost impact on the particular product or service from UPS Proposal One is zero, according to current costing practices.

The second reason is that there are occasional mismatches between the Postal Service’s Matrix B and its PCRA. Some of the products or services listed in Matrix B have no exact equivalent in the PCRA, and vice versa. Thus, as the notes to Table 1 of UPS’s Response to CHIR 1 explain, the cost impacts presented in that table are necessarily estimates. In this case, the inability to report a cost impact in Table 1 does not necessarily indicate that Proposal One would have no effect on costs for that

product or service, merely that the Postal Service would be able to offer a more accurate estimate by resolving the mismatch between its Matrix B and the PCRA in the same way that it does when it prepares its financial reports.

The following table explains the specific reasons why no impact was reported for the products or services in question.

Table CHIR 5-1: Services Without a Reported Cost Impact in Table 1

Service	Reason
First-Class NSAs	In the FY14 Matrix B, this service has no attributable costs within the components that contain inframarginal costs.
Outbound Single-Piece First-Class Mail Int'l	This service is included in the FY14 PCRA but not in the FY14 Matrix B.
Inbound Single-Piece First-Class Mail Int'l	This service is included in the FY14 PCRA but not in the FY14 Matrix B.
Standard Mail NSAs	In the FY14 Matrix B, this service has no attributable costs within the components that contain inframarginal costs.
Alaska Bypass	Component 681 in Matrix B contains premium Domestic Alaska Air Bypass costs incurred in providing service to Alaskan Bush regions.
Inbound Surface Parcel Post (at UPU Rates)	This service has no attributable cost in the FY14 Matrix B.
International Negotiated Service Agreements	This service is included in the FY14 PCRA but not in the FY14 Matrix B.
Total Domestic Ancillary Services	The FY14 Matrix B and the FY14 PCRA aggregate ancillary services differently, especially with respect to international ancillary services. Rather than report a disaggregated impact for Domestic Ancillary Services, UPS has estimated the impact for Total Market Dominant Services as a whole.
Total International Ancillary Services	The FY14 Matrix B and the FY14 PCRA aggregate ancillary services differently, especially with respect to international ancillary services. Rather than report a disaggregated impact for International Ancillary Services, UPS has estimated the impact for Total Market Dominant Services as a whole.
Total Special Services	The FY14 Matrix B and the FY14 PCRA aggregate ancillary services differently, especially with respect to international ancillary services. Rather than report a disaggregated impact for Total Special Services, UPS has estimated the impact for Total Market Dominant Services as a whole.

5. **Please refer to Table 2 on page 41 of the UPS Response to CHIR No. 1. Please explain why Proposal Two is estimated to have no effect on the cost of several products. Please provide a separate explanation for each unaffected product.**

The process for deriving the product-level Proposal Two impact calculations presented in Table 15 of Dr. Neels report, and in Table 4 on page 41 of the UPS response to CHIR No. 1,¹² is essentially the same as for the Proposal One impact calculations. And the reasons why no cost impact is reported for a handful of products or services (accounting for just about 8% of total attributable costs under current costing procedures) are also similar. The specific reasons are provided in the following table.

Table CHIR 5-2: Services Without a Reported Cost Impact in Table 4

Service	Reason
First-Class NSAs	In the FY14 Matrix B, this service has no attributable costs within the components that contain hidden variable costs.
Outbound Single-Piece First-Class Mail Int'l	This service is included in the FY14 PCRA but not in the FY14 Matrix B.
Inbound Single-Piece First-Class Mail Int'l	This service is included in the FY14 PCRA but not in the FY14 Matrix B.
Standard Mail NSAs	In the FY14 Matrix B, this service has no attributable costs within the components that were found to contain hidden variable costs.
Alaska Bypass	Component 681 in Matrix B contains premium Domestic Alaska Air Bypass costs incurred in providing service to Alaskan Bush regions.
Inbound Surface Parcel Post (at UPU Rates)	This service has no attributable cost in the FY14 Matrix B.
International Negotiated Service Agreements	This service is included in the FY14 PCRA but not in the FY14 Matrix B.
Total Domestic Ancillary Services	The FY14 Matrix B and the FY14 PCRA aggregate ancillary services differently, especially with respect to international ancillary services. Rather than report a disaggregated impact for Domestic Ancillary Services, UPS has estimated the impact for Total Market Dominant Services as a whole.
Total International Ancillary Services	The FY14 Matrix B and the FY14 PCRA aggregate ancillary services differently, especially with respect to international ancillary services. Rather than report a disaggregated impact for International Ancillary Services, UPS has estimated the impact for Total Market Dominant Services as a whole.
Total Special Services	The FY14 Matrix B and the FY14 PCRA aggregate ancillary services differently, especially with respect to international ancillary services. Rather than report a disaggregated impact for Total Special Services, UPS has estimated the impact for Total Market Dominant Services as a whole.
Total Competitive International	Hidden variable costs could only be estimated using mail classes that were included in both the Matrix B and the "Revenue, Piece, and Weight" reports (RPWs) as both volume and component level costs were required. The RPWs reported international costs as separate line items while the Matrix B included a subtotal for all International Mail and Services.

¹² The Information Request refers to Table 2 on page 41, but the table on page 41 is Table 4. UPS refers to Table 4, not Table 2, in this Response.

Respectfully submitted,

UNITED PARCEL SERVICE, INC.,

By: /s/ Steig D. Olson
Steig D. Olson
Quinn Emanuel Urquhart & Sullivan, LLP
51 Madison Ave., 22nd Floor
New York, NY 10010
(212) 849-7152
steigolson@quinnemanuel.com

Attorney for UPS